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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. —

UNITED STATES, PETITIONER

v.

DON GILMORE AND SUE GILMORE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The Solicitor General, on behalf of the United States, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Claims in this case.

OPINION BELOW

The opinion below (Appendix, *infra*, pp. 13–25) has not yet been officially reported.

JURISDICTION

The judgment of the Court of Claims was entered on June 7, 1961. (Appendix, *infra*, pp. 13, 25.) The jurisdiction of this Court is invoked under 28 U.S.C. 1255.

QUESTION PRESENTED

Whether legal expenses incurred in a divorce proceeding are deductible, for income tax purposes, as

expenses paid in the conservation of income-producing property.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) *Expenses.*—
>
> * * * * *
>
> (2) [as added by Section 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, 819] *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.
>
> * * * * *
>
> (26 U.S.C. 1952 ed., Sec. 23.)

Section 212 of the Internal Revenue Code of 1954 is similar.

> SEC. 24. ITEMS NOT DEDUCTIBLE.
>
> (a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—
>
> (1) [as amended by Section 127(b) of the Revenue Act of 1942, *supra*] Personal, living, or family expenses, except * * *.
>
> * * * * *
>
> (26 U.S.C. 1952 ed., Sec. 24.)

Section 262 of the Internal Revenue Code of 1954 is similar.

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

> SEC. 39.24(a)-1. *Personal and family expenses.*—* * * Generally, attorneys' fees paid in a suit for divorce or separate maintenance are not deductible. However, the part of an attorney's fee paid in a divorce or separate maintenance proceeding which is properly attributable to the production or collection of amounts includible in gross income under section 22(k) is deductible under section 23(a)(2). * * *
>
> SEC. 39.24(a)-2. *Capital expenditures.*—(a) *Expenditures except non-depreciable mine development expenditures.*—* * * The cost of defending or perfecting title to property constitutes a part of the costs of the property and is not a deductible expense. * * *

STATEMENT

The pertinent facts, as found by the Court of Claims (R. 45–61), may be summarized as follows:

Don Gilmore (the taxpayer) and Dixie Gilmore were married in 1946.[1] They had no children. In April, 1952, they separated and Mrs. Gilmore filed suit for divorce in California, charging her husband with extreme cruelty and adultery. (R. 45, 51; Appendix, *infra*, pp. 25, 31.) In June of that year, Mr. Gilmore filed an answer and a cross-complaint for divorce (R. 45; Appendix, *infra*, p. 25), alleging extreme cruelty by Mrs. Gilmore. (R. 51; Appendix, *infra*, p. 31.)

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[1] Sue Gilmore, a party to this proceeding, is the taxpayer's second wife, whom he married on November 1, 1955. She and the taxpayer filed a joint income tax return in 1955. (R. 45, 58.)

In the divorce proceedings, Mrs. Gilmore made a claim with respect to the taxpayer's principal income-producing property, consisting of holdings in three automobile dealerships which he had acquired prior to his marriage.[2] The stockholdings had increased in value by $600,000 (from $200,000 to $800,000) between 1946 and 1952, and Mrs. Gilmore claimed that this increment was community property under the laws of California. Prior to the divorce trial, she offered to take $275,000 in full settlement of her claim, but the taxpayer rejected the offer because his attorneys advised him that the increment in the value of his holdings was separate property and because he feared that a settlement might result in a cancellation of his dealership franchises. (R. 49–50; Appendix, *infra*, pp. 29–30.)

At the divorce trial, most of the evidence presented by the parties was devoted to the alleged misconduct. Some, though considerably less, testimony, was directed to the question whether the increase in the value of the taxpayer's stock in the automobile deal-

[2] The taxpayer's stockholdings were as follows: 100 percent of the outstanding shares of Don Gilmore-San Francisco; 60 percent of the outstanding shares of Don Gilmore-Riverside; and 73⅓ percent of the outstanding shares of Don Gilmore-Hayward. Each of these was a California corporation which operated as a franchised automobile dealer of a division of the General Motors Corporation. During the taxable years, and for many years previously, the taxpayer was the president and principal managing officer of each of the corporations. He derived substantial income in the form of salaries and dividends from the corporations, largely due to his ownership and control. During 1953 and 1954 his only income from sources unrelated to the corporations was $1,024.90 and $516.60, respectively. He had spent all of his adult life in the retail automobile business and it was the only business he knew (R. 46–48; Appendix, *infra*, pp. 26–28).

erships was community property.[3] After Mrs. Gilmore took the initiative in presenting evidence of misconduct, Mr. Gilmore's attorneys considered it necessary to resist those charges by extensive cross-examination and by evidence of misconduct on Mrs. Gilmore's part. This was undertaken because (1) under California law, the court must award more than 50 percent of the community property, and may award all of it, to the innocent spouse in divorces based on extreme cruelty or adultery; (2) Mrs. Gilmore's charges of misconduct were published in the local newspapers and it was feared that General Motors might cancel the taxpayer's dealership franchises if the allegations were proved; (3) the credibility of the parties became an important factor and the taxpayer's attorneys feared that, if the trial judge believed Mrs. Gilmore's account, he might also find that there was community property and award all or most of it to her; and (4) there was an issue as to whether oral declarations and conduct between the parties had affected the nature of the property in dispute. (R. 51–52; Appendix, *infra*, pp. 31–32.)

In 1953, after trial, the Superior Court found the issues in favor of the taxpayer, granting him an interlocutory divorce, denying Mrs. Gilmore a divorce and holding that there was no community property of the marriage. On October 25, 1955, after an appeal, a remand of the case, and further proceedings in which the Supreme Court of California affirmed the

[3] Other issues were whether Mrs. Gilmore was entitled to alimony and whether two houses in which the parties had lived were held in joint tenancy. Very little time and effort was devoted to these issues by the taxpayer's attorneys. (R. 52; Appendix, *infra*, p. 32.

interlocutory judgment of the Superior Court, a final judgment of divorce in favor of the taxpayer was entered in the trial court.[4] (R. 45; Appendix, *infra*, p. 26.)

As a result of the protracted litigation, the taxpayer was required to pay a total of about $45,911.36 in legal fees for the years 1953, 1954 and 1955 ($32,537.15 for 1953; $8,074.21 for 1954; and approximately $5,300 for 1955). In his income tax returns for 1953 and 1954 (the years here involved), he deducted a substantial portion of the legal fees as an expense incident to defending properties and investments. The Commissioner disallowed the deductions on the ground that the legal fees were personal expenditures and therefore nondeductible under Section 24(a) of the Internal Revenue Code of 1939. The deficiencies were paid and this suit for refund followed. (R. 53–61; Appendix, *infra*, pp. 36–41.)

In the proceedings below, taxpayer claimed, and the Court of Claims held (R. 37–41; Appendix, *infra*, pp. 17–21), that 80 percent of his legal fees were deductible under Section 23(a)(2) of the Internal Revenue Code of 1939 as having been "paid in the conservation of income-producing property." (R. 40; Appendix, *infra*, p. 20.)[5]

REASONS FOR GRANTING THE WRIT

1. The decision below conflicts in principle with the decision of this Court in *Lykes* v. *United States*, 343 U.S. 118, and is directly opposed to the decision of the

[4] The two residences were held to be joint tenancy property of the parties. (R. 45; Appendix, *infra*, p. 25.)

[5] The remaining 20 percent was allocated to obtaining the divorce, as distinguished from protecting property.

Court of Appeals for the Second Circuit in *Lewis* v. *Commissioner*, 253 F. 2d 821.

The issue in *Lykes*, as here, was the deductibility (as a nonbusiness expense) under Section 23(a)(2) of the Internal Revenue Code of 1939 (*supra*, p. 2)[6] of legal expenses arising out of intra-familial financial matters. Specifically, the question was whether attorneys' fees paid in contesting a gift tax liability were deductible. The deduction was denied on the grounds that Section 24(a)(1) precludes a deduction for "[p]ersonal, living, or family expenses * * *" and that the legal expenses, having their roots in the making of a gift to members of the taxpayer's family, were attributable to a personal or family matter. The Court's holding resulted from the application of principles established in prior cases, *i.e.*, that the source of a liability determines its nature (see *Deputy* v. *duPont*, 308 U.S. 488) and that deductibility depends upon the proximate cause of the expenditure (see *Kornhauser* v. *United States*, 276 U.S. 145). Thus, the Court stated in *Lykes* (343 U.S. at 125): "Legal expenses do not become deductible merely because they are paid for services which relieve a taxpayer of liability. * * * Section 23(a)(2) * * * has been applied to expenses on the basis of their immediate purposes rather than upon the basis of the remote contributions they might make to the conservation of a taxpayer's income-producing assets * * *."

[6] Section 212 of the Internal Revenue Code is also involved here, since it applies to 1954 and subsequent years, but it is similar to Section 23(a)(2) of the 1939 Code.

In the instant case, the legal fees held deductible on the theory that they were expenses "paid in the conservation of income-producing property" (R. 40; Appendix, *infra*, p. 20) are also directly attributable to a personal or family matter—the marital relationship. That relationship was the source of the potential liability which taxpayer resisted in the divorce proceeding. Simply stated, it was marital discord—indisputably, a personal matter—which was the immediate cause of the expenditures for legal services. To be sure, the amount and character of Mrs. Gilmore's claim constituted a serious threat to taxpayer's income-producing property. But as this Court stated in *Lykes* (343 U.S. at 125), neither the size of a claimed liability nor the urgency to resist it determines the character of the legal expenses paid in connection with it; the expenses are nondeductible if they are attributable to a personal matter.

The conflict between the decision below and the basic principles exemplified by *Lykes* is placed in sharp focus by the decision of the Second Circuit in *Lewis* v. *Commissioner*, 253 F. 2d 821. In that case, the taxpayer's wife sued for a legal separation and demanded 50 percent of the stock owned by the taxpayer in a publishing company, as well as 50 percent of various securities which she claimed were held in brokerage accounts in her name and that of the taxpayer jointly. Although a major portion of the services rendered by the taxpayer's counsel related to arrangements for maintenance and support and to the adjustment of the respective property rights of the

parties, the Second Circuit held that none of the legal fees incurred by the taxpayer were deductible.

The conflict has been openly recognized. Thus, the court below stated (R. 38; Appendix, *infra*, p. 18) that there are two lines of authority, one following *Lykes* and the other following *Baer* v. *Commissioner*, 196 F. 2d 646 (C.A. 8th). It concluded that *Baer* represents the correct approach in instances where the scope of the wife's claim is such that "a substantial part of the income-producing property" of the husband is threatened (R. 38–39; Appendix, *infra*, pp. 18–19). But that was also the situation in *Lewis*, in which the court denied all deductions for legal expenses and stated (253 F. 2d at 826–827), "With all deference, we cannot reconcile this decision [*Baer*] with that of the Supreme Court in *Lykes* v. *United States*, *supra*; hence we decline to follow it."

Some courts, although not expressly rejecting *Baer*, have denied a deduction for legal expenses incurred in a divorce, separation or maintenance proceeding and distinguished *Baer* on the ground that it involved expenses related not to the question of liability but to the manner in which the liability might be met. See *Smith's Estate* v. *Commissioner*, 208 F. 2d 349, 354 (C.A. 3d); *Harris* v. *United States*, 275 F. 2d 238, 240 (C.A. 9th); *Tressler* v. *Commissioner*, 228 F. 2d 356, 361 (C.A. 9th); *Howard* v. *Commissioner*, 202 F. 2d 28, 30 (C.A. 9th). Two of the circuits which have followed *Baer* have also stressed this distinction. See *Owens* v. *Commissioner*, 273 F. 2d 251, 256 (C.A. 5th); *United States* v. *Patrick*, 288 F. 2d 292, 294–295, 296 (C.A. 4th). The Court of Claims drew a similar distinction in its prior decisions in *McMurtry* v. *United States*, 132 F. Supp. 114, 116, and *Davis* v. *United States*, 287 F. 2d 168 (petition for a writ of certiorari pending on another issue). But even if that distinction were sound, it would not explain the result in the instant case where the principal expense was in resisting liability (successfully, as events proved). Note, also, that in *Lewis* the court disallowed both the expenses involved

2. The question presented by this petition is a recurrent one. In addition to the instant case and *United States* v. *Patrick*, 288 F. 2d 292 (C.A. 4th), in which we are concurrently filing a petition for a writ of certiorari, we know of fourteen cases now pending in the federal courts which involve the issue of deductibility of legal expenses incurred in connection with separation or divorce proceedings.[8] Many such claims are regularly denied administratively. It is of obvious importance, therefore, that the conflict—one which inevitably leads to inequity among taxpayers—be resolved by this Court.

The decision below, moreover, is one which has broad implications. There are numerous situations in which it is necessary to distinguish between conservatory expenses (expenses incurred for the management, conservation or maintenance of property held

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in the determination of the husband's liability and those related to the adjustment of the spouses' property rights. The Tax Court has consistently taken the same view as the *Lewis* decision. *Douglas* v. *Commissioner*, 22 T.C. 349, 355; *Estate of Walsh* v. *Commissioner*, 28 T.C. 1274, 1277; *Joyce* v. *Commissioner*, 3 B.T.A. 393, 397. That result is also required by Treasury Regulations 118, Sec. 39.24(a)-1, *supra*, p. 3.

The decision below is erroneous, we believe, in another respect. Assuming, *arguendo*, that taxpayer's expenses were not personal expenditures within Section 24(a)(1), they were attributable to defense of the wife's claims that the appreciation in the value of the husband's stock was community property. Expenditures in defense of title are capital expenditures and not deductible. *Harris* v. *United States*, *supra*; *Lewis* v. *Commissioner*, *supra*; Treasury Regulations 118, Sec. 39.24(a)-2, *supra*, p. 3.

[8] As indicated in note 7, *supra*, the cases already litigated have resulted in considerable confusion.

for the production of income) and personal expenses which serve to protect financial well-being or to guard against the imposition of liabilities. Consider, for example, expenses incurred in resisting or compromising an action based on a personal tort. If it is enough, as the Court of Claims holds, that a substantial portion of the taxpayer's income-producing property is threatened by a potential adverse judgment, the door is opened wide.

Although we shall not labor the merits in this petition, it is to be observed, as this Court noted in *Lykes* (343 U.S. at 121), that Section 23(a)(2) was enacted to change the result of *Higgins* v. *Commissioner*, 312 U.S. 212, a case which held that an individual taxpayer's expenses in managing his securities were not deductible because they were not incurred in the course of his "trade or business." The legislation reflected a decision by Congress to allow expenditures which had a "business" character, albeit they were not part and parcel of the taxpayer's regular business or profession. But, as emphasized in *Lykes* (p. 122), nothing in the legislation or its history indicates that "Congress sought to make such a change of policy as would authorize widespread deductibility of personal, living or family expenditures in the face of § 24(1)." In our view, the decision of the Court of Claims in the instant case does portend such a "change of policy".

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted.

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JULY 1961.

APPENDIX

In the United States Court of Claims

No. 374–58

(Decided June 7, 1961)

DON GILMORE AND SUE GILMORE v. THE UNITED STATES

Eli Freed for plaintiffs.

Benjamin H. Pester, with whom was *Assistant Attorney General Louis F. Oberdorfer*, for defendant. *James P. Garland* and *Lyle M. Turner* on the brief.

OPINION

LARAMORE, *Judge*, delivered the opinion of the court:

This is a suit to recover the alleged overpayments of income tax, plus interest accrued, for the taxable years 1953, 1954, and 1955. The defendant counterclaims for the years 1953 and 1954.

Plaintiff[1] is the owner of 100 percent of the shares issued and outstanding of a corporation named Don Gilmore—San Francisco. He is also the owner of 60 percent of the issued and outstanding stock of a second corporation, Don Gilmore—Riverside. In addition, he is the owner of 73⅓ percent of the stock issued and out-standing of a third corporation, Don Gilmore—Hayward. Each of the three named corporations is a franchised dealer of a division of General Motors Corporation. Each of these businesses operated under an annually renewable franchise contract which contained a clause giving the manufacturer the uni-

[1] Sue Gilmore is the present wife of plaintiff. They were married on November 1, 1955. Hereafter, any reference to the term "plaintiffs" in the plural number, pertains to the tax year 1955 only and refers to both Don and Sue Gilmore. The singular "plaintiff" refers solely to Don Gilmore.

lateral right to terminate the franchise on a 90-day notice. The plaintiff is, and for many years has been, the president and principal managing officer of each of the three above-mentioned corporations. He has received the following combined gross salaries from them:

1949	$79,800.00
1950	61,316.65
1951	66,799.92
1952	66,799.92
1953	66,799.92

From his ownership of stock he received as dividends:

1948	$109,484.80
1949	69,438.23
1950	50,003.48
1951	114,625.65
1952	73,044.00
1953 (D. Gilmore—San Francisco only)	39,657.02

The only income of plaintiff from sources unrelated to these automobile dealerships for the years in suit was $1,024.90 in 1953, and $516.60 in 1954.

From March 2, 1946 to October 25, 1955, plaintiff was married to one Dixie Gilmore. During all of this time the couple were residents of California. On April 8, 1952, they separated. Two days later, Dixie Gilmore filed for divorce in the Superior Court of the State of California in and for the County of Marin where the parties resided. On June 16, 1952, the plaintiff in the instant case filed an answer to the complaint and a cross-complaint for divorce. This action came to trial, commencing March 16, 1953, and continuing on order until April 24, 1953. The trial court found in favor of Don Gilmore, granting him an interlocutory divorce, denying the divorce to the wife, and decreed that there was no community property of the marriage.

Within the time allowed, Dixie Gilmore appealed this interlocutory judgment to the District Court of Appeals, State of California, First Appellate District. That court, on April 26, 1955, entered its decision reversing the judgment below and ordering a new trial. Thereupon, Don Gilmore petitioned for a hearing of the appeal in the Supreme Court of California. A hearing was granted in the case, and the decision of the District Court of Appeals was vacated by the Supreme Court, and the judgment of the trial court in all

respects affirmed by it on September 23, 1955. After the Supreme Court had affirmed the interlocutory judgment of divorce, a final judgment of divorce in favor of Don Gilmore and against Dixie Gilmore was entered in the trial court on October 25, 1955. As a result of the protracted litigation proceedings, Mr. Gilmore was required to pay legal fees in the amount of $32,537.15 for the year 1953, $8,074.21 for the year 1954, and approximately $5,300 for the year 1955.

The question of community property was an important one during the divorce proceedings. Prior to plaintiff's marriage in 1946, the value of his stockholdings in the three automobile dealerships was approximately $200,000. At the time of their separation, the value of these stockholdings had risen to approximately $800,000. This is an appreciation of $600,000, and it was the contention of Dixie Gilmore that this appreciation was community property. On this basis she contended that she was entitled to one-half the amount, but she was willing to settle for $275,000.

Plaintiff timely filed his individual income tax return for all three years in question. Among other things, plaintiff took a deduction of 80 percent of the cost of the fees involved in the divorce proceedings as an expense incident to the defending of properties and investments. He also claimed deductions in his returns of the full amount of certain State taxes which were due on his full salary. Plaintiff, because he is an employee, had a certain amount of his wages withheld by his employer. In estimating his tax liabilities for 1953 and 1954, plaintiff credited himself with the full amount withheld.

Upon an audit of plaintiff's 1953 and 1954 individual income tax returns the Commissioner of Internal Revenue made a number of disallowances and adjustments, based on the following determinations:

(a) The principal disallowances resulted from the Commissioner's determination that the attorneys' fees, accountant's fee, court reporters' fees, and printing costs, which Don Gilmore paid in 1953 and 1954 in connection with the divorce action, were personal expenditures of Don Gilmore and were not deductible under Section 24(a) of the 1939 Internal Revenue Code.

(b) The Commissioner determined that only $9,762, or one-half of the $19,524 income taxes withheld from Don Gilmore in 1953 should be credited to him, and this resulted in a finding by the Commissioner that $4,881 of the tax liability reported on the 1953 return of Don Gilmore had never been paid.

(c) The Commissioner of Internal Revenue also determined that of the $5,643.10, which Don Gilmore had paid in 1953 for State income and unemployment taxes, Mr. Gilmore was entitled to a credit in his return of only one-half, or $2,821.55, and that the balance was deductible by Dixie Gilmore.

(d) In his 1953 income tax return, Don Gilmore had erroneously reported that of the $66,799.92 of salaries paid to him during that year, the amount of $50,099.92 was taxable to himself individually and the balance of $16,700 was taxable to Dixie Gilmore. The error caused his individual income for the year 1953 to be overstated by the amount of $16,699.96. This error was recognized by the Commissioner of Internal Revenue, who made an adjustment showing that only one-half of the total salaries paid were taxable to Don Gilmore individually.

As a result of various disallowances and adjustments the Commissioner assessed deficiencies in income taxes against plaintiff as follows:

Year	*Tax*	*Interest*	*Total*
1953	$18,883.26	$4,264.25	$23,147.51
1954	3,762.21	583.12	4,345.33

On November 1, 1955, Don Gilmore and Sue Gilmore were married. When they filed their joint income tax return on April 15, 1956, they claimed a credit for all taxes withheld from Don Gilmore's salary in 1955. In addition they reported as income the total amount of the salary as their joint income. They filed a timely claim for refund of income taxes paid for the year 1955 on the grounds that income received prior to October 25, 1955, was the community property of Don and Dixie Gilmore and that one-half is taxable to Dixie Gilmore.

The defendant in this case asserts a counterclaim against Don Gilmore for the years 1953 and 1954. As a result of the

Commissioner's adjustments concerning the income tax returns of Dixie Gilmore, it was determined that she had a tax balance due of $3,863.78, plus interest for the year 1953. It was similarly determined that she owed $78.93, plus interest, for 1954. A demand for payment was made on Dixie Gilmore on January 7, 1958. Defendant contends that plaintiff, as the husband of Dixie Gilmore, had full and complete control of the community income and is liable for the income taxes of Dixie Gilmore, together with the interest due thereon.

The issues that present themselves are patently discernable from the foregoing sequence of events and we shall direct our answers in the order that the questions appear.

This court has recently had occasion to review the question of deductibility of legal expenses incurred in divorce litigation. *Davis v. United States*, No. 516-58, decided March 1, 1961. In that case the plaintiff attempted to deduct two types of legal fees paid by him: first, legal fees paid for tax advice, and second, legal fees incurred in connection with the protection of income-producing property. This court allowed the deduction as to the first type of legal fees, but denied the deduction as to the second type. In the instant case we are concerned with deductions of the second type; *i.e.*, expenses incurred in connection with the protection of income-producing property.

The general rule is that attorneys' fees paid in connection with a divorce are not deductible. Therefore, in order to bring himself under the section permitting the deduction, plaintiff must show that the legal expenses were incurred in matters directly related to his business or the management, conservation, or maintenance of property held for the production of income. *Port v. United States*, 143 Ct. Cl. 334.

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939, provide:

> § 39.24(a)-1 *Personal and family expenses.* * * * Generally, attorneys' fees paid in a suit for divorce or separate maintenance are not deductible. However, the part of an attorney's fee paid in a divorce or separate maintenance proceeding which is properly attributable to the production or collection of amounts includible in gross income under section 22(k) is deductible under section 23(a)(2). * * *.

In *Davis* v. *United States*, *supra*, we discussed the pertinent cases in this area of the law. We pointed out that there were two groups of cases followed by the courts. One class of authority follows the decision in *Lykes* v. *United States*, 343 U.S. 118, and the other class follows the decision in *Baer* v. *Commissioner*, 196 F. 2d 646. We indicated a belief that it was not necessary to choose which decision is right in the premises because of factual differences in the two lines of cases. We are still of this opinion. However, the facts in the instant case clearly come under the rule laid down by the court in the latter line of cases. At the time of commencement of the divorce proceedings, plaintiff was 62 years of age; he had spent all his adult life in the retail automobile business; he would not have been able to gain employment in some other business, neither could he obtain employment as president or general manager of an automobile dealership, except through a controlling stock ownership interest. The evidence is clear that the large salary paid to plaintiff was not in return for his services rendered, but because he was the controlling stockholder. It is not too difficult to imagine that an irate ex-wife, if she gained control of a corporation, would dispose of her ex-husband as president. Thus, plaintiff was fighting not only to protect his income-producing property, but to prevent the loss of his salary as well.

In addition to the possible loss of his income, and the possible loss of 50 percent or more of the appreciation in the value of the stock, plaintiff could have lost his franchise with the General Motors Corporation through a proviso in the contract permitting a termination in the event of:

> Any sale, transfer, relinquishment, voluntary or involuntary, by operation of law or otherwise, of any interest in the direct or indirect ownership or active management of dealership without the prior written approval of Seller.

The sensational nature of the divorce charges of adultery and misconduct, brought by Dixie Gilmore, were published in the local papers. This adverse publicity created a real fear that General Motors might terminate the franchise if the allegations were established and a divorce granted to the wife. Even though Dixie Gilmore took the initiative in raising charges of misconduct, the plaintiff resisted these

charges and brought charges of his own. He did this not because he opposed the idea of his wife obtaining a divorce, as evidenced by the fact that six days after the divorce became final he married again, but because of the consequences that would result from a determination that the charges brought against him were well founded. It is important to notice that under California law, the court must award *more* than 50 percent of the community property, and may award *all* of the community property to the innocent spouse in divorces based on extreme cruelty or adultery. There can be little doubt that Dixie Gilmore sought more than a divorce. If that was all she wanted, she received it at the trial level, but this divorce action went all the way to the Supreme Court of California. Dixie Gilmore wanted a substantial part of the income-producing property of plaintiff.

The Internal Revenue Code of 1939, 26 U.S.C. (1946 Ed.), which was in effect at that time, states:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) Expenses.
>
> * * * * * *
>
> (2) Non-trade or non-business expenses.
>
> In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

Of course it is true that in every divorce case a certain amount of the legal expenses are incurred for the purpose of obtaining the divorce and a certain amount are incurred in an effort to conserve the estate and are not necessarily deductible under section 23(a)(2), but when the facts of a particular case clearly indicate that the property, around which the controversy evolves, is held for the production of income and without this property the litigant might be denied not only the property itself but the means of earning a livelihood, then it must come under the provisions of section 23(a)(2), *supra*. The only question then is the allocation of the expenses to this phase of the proceedings. Here, the plaintiff claims that 80 percent of the legal ex-

penses were incurred in the conservation of his income-producing property. The commissioner of this court found that at least 80 percent of the legal expenses were so incurred and this is supported by the evidence. The defendant contends that it is the burden of the taxpayer to establish the exact amount to which he is entitled and, if he cannot meet this requirement, then the deduction must be denied. In considering this contention our attention immediately focuses on the landmark case of *Cohan* v. *Commissioner*, 39 F. 2d 540, where Judge Learned Hand directed the court to this question, at page 543:

> * * * The Board refused to allow him any part of this, on the ground that it was impossible to tell how much he had in fact spent, in the absence of any items or details. The question is how far this refusal is justified, in view of the finding that he had spent much and that the sums were allowable expenses. Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. * * *.

This decision has proved a valuable and workable rule over the years and has withstood the attacks made upon it by the Internal Revenue Service. We are not prepared to sanction an outright frontal attack upon this rule.

We are of the opinion that the evidence presented by the plaintiff is sufficient to support a finding that 80 percent of the legal expenses incurred in this instance were paid in the conservation of income-producing property. Also, we can find no merit in defendant's further contention that the expenses were actually incurred in defense or perfection of title of a capital asset. The stocks in question belonged to plaintiff before he was married and the wife never suggested that he did not hold perfect title to them. In fact, to do so would have defeated her purpose because if he did not have perfect title in the stocks she could not have asserted an interest in the appreciation thereon. Under these circumstances there can be no question that plaintiff has perfect right to the stocks.

Therefore, following the same rationale as in the *Davis* case, *supra*, we reach a contrary conclusion. The facts in

the instant case indicate a situation similar to the facts in *McMurtry* v. *United States*, 132 Ct. Cl. 418; *Baer* v. *Commissioner*, *supra*; *Bowers* v. *Commissioner*, 243 F. 2d 904; and *Fisher* v. *United States*, 157 F. Supp. 364.

We turn next to the question whether the defendant was correct in crediting plaintiff with only one-half of the state taxes paid by him, and one-half of the Federal taxes withheld from his salary for the years 1953 and 1954.

Section 35 of the 1939 Internal Revenue Code provides:

> § 35. *Credit for tax withheld on wages.*
>
> The amount deducted and withheld as tax under Subchapter D of Chapter 9 during any calendar year upon the wages of any individual shall be allowed as a credit to the recipient of the income against the tax imposed by this chapter for the taxable year beginning in such calendar year. * * *

The Regulations then define who the recipient of the income is:

> § 39.35–1. *Credit for tax withheld on wages.*
>
> * * * For the purpose of the credit, the recipient of the income is the person subject to tax imposed under chapter 1 upon the wages from which the tax was withheld. For instance, if a husband and wife domiciled in a State recognized as a community property State for Federal tax purposes make separate returns, each reporting for income tax purposes one-half of the wages received by the husband, each spouse is entitled to one-half of the credit allowable for the tax withheld at source with respect to such wages.

The authority in California is clear that the earnings of the husband continue to be community income until the final judgment of divorce. *Waters* v. *Waters*, 170 P. 2d 494. The amounts of these salaries were community income owned equally by Don Gilmore and Dixie Gilmore and one half of such community income was taxable to Don Gilmore and the other one-half to Dixie Gilmore. In filing his income tax returns for the years 1953 and 1954, the plaintiff arbitrarily attributed a high percentage of the income to himself and a low percentage to his wife. The only way we know that the whole of something may be divided equally into two parts is by dividing it in half. Therefore, we are of

the opinion that the defendant was correct in adjusting plaintiff's tax return to reflect this amount of income. This necessarily brings us to the question of what amount of deductions should be allowed to plaintiff considering that only half of the total salaries was taxable to plaintiff individually. We sustain the Government on the issue pertaining to the amount withheld from the salaries. It is apparent that if the salaries are community property, to be divided 50–50, any amount withheld to pay an obligation of both should be considered to have been withheld from each. This is consistent with Treasury Regulation 118, § 39.35–1, and it appears to be a fair and equitable solution to the problem.

On the other hand, the answer to the question of which party is entitled to the deduction for California personal income and unemployment taxes is quite different. The general rule is that a taxpayer cannot deduct taxes "paid or accrued" unless he is legally liable to the authority imposing the tax. The applicable California statute provides:

> § 18555. *Liability of spouses; community income; joint returns.*
>
> The spouse who controls the disposition of or who receives or spends community income as well as the spouse who is taxable on such income is liable for the payment of the taxes imposed by this part of such income. * * *. [California Revenue and Taxation Code (61 West's Ann. Calif. Codes)]

We think this statute establishes the liability of the plaintiff for the state tax responsibilities of his wife. Since plaintiff paid the taxes he is entitled to the deduction. In the case of *Al Jolson*, 3 T.C. 1184, the husband was entitled to deduct the wife's state income taxes which he paid because he was personally liable under the state law.

After these adjustments are made there will remain a tax deficiency on the part of Dixie Gilmore for the years 1953 and 1954. The defendant counterclaims for the amounts of these deficiencies on the basis that they are taxes incurred upon the community income of Don and Dixie Gilmore. We agree that the salaries paid plaintiff during this period were community property, but it does not follow that plaintiff is liable for the tax deficiencies of his wife. In our search of the authorities we have been able to find only two unreported

cases that stand for the proposition that the community property is 100 percent liable for the tax liabilities of one of the parties when they had filed separate returns. *G. J. Rodgers*, 51-2 USTC, ¶9495; *R. F. Ryan*, 51-2 USTC, ¶9493. The weight of authority is to the contrary. In *Marjorie Hunt*, 22 T.C. 228, the Tax Court stated at page 230:

> * * * For purposes of Federal income taxation, each spouse is equally liable for payment of the tax on his or her respective equal share of the community income. *United States* v. *Malcolm*, 282 U.S. 792 (1931); *Poe* v. *Seaborn*, 282 U.S. 101 (1930). This liability is fixed and definite. It is not a means of splitting income which may be voluntarily chosen or elected to minimize taxes. * * * Her liability for tax ceases only when her interest in the community income ceases. * * *

Again, in *Harrold*, 22 T.C. 625, the court in referring to the two unreported cases mentioned previously stated at page 628:

> * * * It is contrary to a line of cases in which we, and other courts, have held that the powers of management conferred upon the husband by community property laws do not render him personally liable for taxes on his wife's share of the community income. *Poe* v. *Seaborn*, 282 U.S. 101 (1930); *Paul Cavanagh*, 42 B.T.A. 1037 (1940), affirmed on another issue, 125 F. 2d 366 (C.A. 9, 1942); * * * The following explanation given by this tribunal in the *Cavanagh* case, pages 1043 and 1044, adequately answers petitioner's contention:
>
> > "The fact that under the California law the husband has a broad power of control does not detract from the wife's interest. This power is conferred upon him merely as the agent of the community and does not make him the owner of all the community property and income, nor negative the wife's present interest there as equal coowner. * * *.

Although the *Harrold* case, *supra*, was reversed on factual grounds in *Harrold* v. *Commissioner*, 232 F. 2d 527 (C.A. 9th), the question whether an overpayment refundable to the husband was to be charged with taxes due from the wife was not considered by the Court of Appeals. The whole concept of community property is a legal fiction. It is no more fictitious to say that the wife earned half the husband's salary by housekeeping than it is to say that each earned half the total income through their own efforts. Once the

law accepts the concept of two individuals each owning an equal half of the income and each individual files a separate return that is the end of it. Each party must be treated as an individual, as if they were not husband and wife. In *Harrold*, *supra*, the court in attempting to clarify this area of the law emphatically stated at page 629:

> * * * We subsequently emphasized in *H. B. Perine et al.*, *supra*, that we could not require the respondent to do so, stating in part:
>
> > The spouses became separate and distinct taxpayers under the statute upon the filing of separate returns of the community income, and the situation is no different than it would be if the taxpayers were other than husband and wife. They being separate taxpayers, we lack authority to require the respondent to credit the proposed deficiency determined against the wife with an overpayment of tax by the husband. *Alexander Vaysse*, 8 B.T.A. 587. Cf. *John W. Preston*, 21 B.T.A. 840.

The defendant cites *Clayton* v. *United States*, 70 Ct. Cl. 740, cert. denied, 283 U.S. 860, and *Lattimore et al.* v. *United States*, 82 Ct. Cl. 97, as supporting the allocation of an overpayment by one spouse to a deficiency of the other. However, in each of those cases the taxpayers originally filed a joint return, indicating that the amount paid with the joint return was intended to be applied to the tax liabilities of each. The defendant also relies on another decision of this court, *Santos* v. *United States*, No. 433-58, decided May 4, 1960, 277 F. 2d 806. The obvious distinction is in that case the law applicable was the Hawaiian Code which made the community property liable, not the California Code, and as the defendant points out in its brief:

> Legal rights, liabilities and interests of husband and wife are created by state law, and the Federal revenue laws determine how the interests and liabilities as created shall be subject to income taxes. *Trapp* v. *United States*, 177 F. 2d 1 (C.A. 10th).

As a consequence of the above-stated reasons, we find that the defendant is not entitled to recover on its counterclaim.

This brings us to the last issue concerning plaintiff's liability for 1955. The Government concedes that the salaries of plaintiff from January 1, 1955 to October 25, 1955,

were community income to him and Dixie Gilmore at the time the divorce became final. Therefore, plaintiffs were required to include only one-half the income received during this period in their 1955 joint tax return. It should be mentioned in passing that the tax return of Dixie Gilmore for 1955 does not indicate a tax deficiency; in fact, there is an overassessment of $1,895.76, which the defendant might apply against Dixie Gilmore's tax deficiencies for 1953 and 1954.

It is so ordered.

DURFEE, *Judge*; MADDEN, *Judge*; WHITAKER, *Judge*; and JONES, *Chief Judge*, concur.

FINDINGS OF FACT

The court, having considered the evidence, the report of Trial Commissioner Wilson Cowen, and the briefs and argument of counsel, makes findings of fact as follows:

1. Plaintiffs are and since November 1, 1955, have been husband and wife. They are citizens and residents of California.

2. From March 2, 1946 to October 25, 1955, plaintiff Don Gilmore was married to one Dixie Gilmore. During all of their marriage, Don Gilmore and Dixie Gilmore were residents of California.

3. On April 8, 1952, Don Gilmore and Dixie Gilmore were separated after six years, one month and six days of childless marriage. On April 10, 1952, Dixie Gilmore filed a complaint for divorce against Don Gilmore in the Superior Court of the State of California in and for the County of Marin, where the parties resided. On June 16, 1952, Don Gilmore filed an answer to this complaint and a cross-complaint for divorce against Dixie Gilmore. This action came to trial in due course in the Superior Court, commencing March 16, 1953, and continuing in order until April 24, 1953. The trial court found the issues in favor of Don Gilmore, denied Dixie Gilmore a divorce from Don Gilmore, and granted Don Gilmore an interlocutory judgment of divorce from Dixie Gilmore, wherein it decreed that there was no community property of the marriage, adjudged two residences to be joint tenancy property of the parties, and determined contrary to her claims that Dixie Gilmore had no community

interest in certain property, more specifically described hereafter, which stood of record as the separate property of Don Gilmore.

4. Dixie Gilmore appealed from this interlocutory judgment to the District Court of Appeal, State of California, First Appellate District. That court on April 26, 1955, entered its decision reversing the judgment below and ordering a new trial. Thereupon respondent Don Gilmore petitioned for a hearing of the appeal in the Supreme Court of the State of California. A hearing was granted in the case, and the decision of the District Court of Appeal was vacated by the Supreme Court, and the judgment of the trial court in all respects affirmed by it on September 23, 1955. The decision of the Supreme Court is reported at 45 Cal. 2d 142.

5. After the Supreme Court of California had affirmed the interlocutory judgment of divorce, a final judgment of divorce in favor of Don Gilmore and against Dixie Gilmore was entered in the Superior Court of the State of California in and for the County of Marin on October 25, 1955.

6. In his divorce litigation with Dixie Gilmore plaintiff Don Gilmore was represented at all times by Michael L. Haun, Esquire, of the California bar, and from the outset of the litigation until about March 13, 1953, also by Walter F. Freitas, Esquire, of the law firm of Freitas, Freitas & Allen. From January or February 1953, until the conclusion of this litigation, plaintiff Don Gilmore was also represented therein by Wallace S. Myers, Esquire, of the law firm of Myers & Meehan. Dixie Gilmore's attorneys in said litigation from its inception until August 18, 1953, were Leslie C. Gillen, Esquire, and Charles A. Christin, Esquire. After that date and until the end of the litigation, her attorneys were James Martin MacInnis, Esquire, and Nicholas Alaga, Esquire.

7. When Dixie Gilmore commenced her action for a divorce against plaintiff Don Gilmore on April 10, 1952, and when that action was tried, Don Gilmore individually was the record owner of the following securities:

(a) 3,000 shares of the common stock of Don Gilmore—San Francisco, a California corporation, being 100 percent of the issued and outstanding stock of said corporation;

(b) 1,500 shares of the common stock of Don Gilmore—Riverside, a California corporation, being 60 percent of the issued and outstanding stock of said corporation. The remaining shares of stock of this corporation were then owned by Thomas E. Brady and H. J. McCullough.

(c) 1,833⅓ shares of the common stock of Don Gilmore—Hayward, a California corporation, being 73⅓ percent of the issued and outstanding stock of said corporation. The remaining shares of stock of this corporation were then owned by C. N. Wilson and H. J. McCullough.

All of his stock interests in these corporations had been owned by Don Gilmore continuously since a date prior to his marriage to Dixie Gilmore.

8. For many years prior to the divorce litigation and during that litigation, Don Gilmore—San Francisco (a corporation), was engaged in the business of operating a franchised Chevrolet dealership for the retail sale and servicing of new and used automobiles and trucks in San Francisco, California. During the same period, Don Gilmore—Riverside (a corporation), carried on a like business as a franchised Pontiac dealership in Riverside, California, and Don Gilmore—Hayward (a corporation), carried on a like business as a franchised Chevrolet dealership in Hayward, California. Each of these businesses operated under an annually renewable franchise contract with a division of General Motors Corporation; each franchise contract contained a clause giving the manufacturer the unilateral right to terminate the franchise on 90 days' notice.

9. For many years prior to the trial of the divorce action between Dixie Gilmore and himself, plaintiff Don Gilmore had been the president and principal managing officer of each of the three above-mentioned corporations. He had received the following combined gross salaries from them:

1949	$79,800.00
1950	61,316.65
1951	66,799.92
1952	66,799.92

10. In 1953, the year in which the divorce action was tried, Mr. Gilmore received salaries as president of the three corporations in the total combined amount of $66,799.92, broken down as follows:

San Francisco	$49,999.92
Hayward	10,800.00
Riverside	6,000.00

11. From his ownership of stock in the foregoing corporations Don Gilmore had received the following dividends in recent years prior to 1953:

1948	$109,484.80
1949	69,438.23
1950	50,663.48
1951	114,625.65
1952	73,044.00

In 1953 Don Gilmore received a dividend from Don Gilmore—San Francisco, in the amount of $39,657.02.

12. The only income of Don Gilmore from sources unrelated to these automobile dealerships for the years in suit was $1,024.90 in 1953, and $516.60 in 1954.

13. The salaries paid to Don Gilmore by the three automobile dealerships, and particularly the large portion thereof paid to him by Don Gilmore—San Francisco, were generous for the services he performed. He was paid these salaries only because of his controlling stock ownerships in these corporations. His salaries for corresponding positions would have to be greatly reduced if he were employed by corporations which he did not own outright or control.

14. Don Gilmore had spent all of his adult life in the retail automobile business. This was the only business he knew. In 1952 and 1953, he was 62 years of age, and too old to get another job as president or general manager of an automobile dealership, except through a controlling stock ownership interest.

15. Among the provisions of the automobile dealerships' franchise contracts was a Minimum Capital Standard Agreement, by which the manufacturer required each dealership to maintain a stated minimum of total owned capital. In the case of Don Gilmore—San Francisco, the total owned capital required by the Chevrolet Division of General Motors Corporation for the year commencing November 1, 1954, was $556,283. As of July 31, 1954, the total owned capital of that corporation was $626,486, all of which was owned by Don Gilmore individually.

16. The franchise contracts also provided that the General Motors Corporation could immediately terminate the fran-

chises by delivering to the dealer or his representative a written notice of termination in the event of:

> Any sale, transfer, relinquishment, voluntary or involuntary, by operation of law or otherwise, of any interest in the direct or indirect ownership or active management of dealership without the prior written approval of Seller.

17. Shortly after Don and Dixie Gilmore first separated about April 8, 1952, Mr. Haun, Mr. Gilmore's attorney, had one or two discussions with Mrs. Gilmore's attorney in an effort to determine whether there was a possibility of saving the marriage. However, it was soon evident that there was no possibility of a reconciliation, and no further efforts to save the marriage were made after April 15, 1952.

18. In May 1952, Don Gilmore had accepted the fact that his marriage to Dixie was beyond repair. He was willing to have a divorce granted to Dixie and to pay her a reasonable amount of alimony for a reasonable period. In principle, Dixie's demands that she should obtain the divorce and that she should receive an appropriate amount of alimony were acceptable to Don Gilmore and to his counsel.

19. At the time of his marriage to Dixie Gilmore in 1946, the value of Don Gilmore's stockholdings in the three automobile dealerships was approximately $200,000. At the time of their separation, the total value of these stockholdings had risen to approximately $800,000.

In 1952 and prior to the trial of the divorce suit, Michael Haun and, subsequently, Walter F. Freitas, as attorneys for Don Gilmore, had conferences with Messrs. Gillen and Christin, who represented Dixie Gilmore, in an effort to settle the litigation. In each of these conferences, Dixie's attorneys took the position that the increase of approximately $600,000 in the value of Don Gilmore's stockholdings was money earned by virtue of his personal services to the corporations and, therefore, was community property under the laws of California. On this basis, they contended that Dixie Gilmore was entitled to one-half of the value of the increase but stated that if Don Gilmore would pay Dixie Gilmore $275,000 in cash, she would accept that in full settlement of her claim.

During the divorce trial, Dixie Gilmore sought to recover $300,000 as her community share of the $600,000 increase in the value of the stock.

20. Don Gilmore rejected Dixie Gilmore's demands for a settlement payment of $275,000 for the following reasons:

(a) It would have been impossible for him to raise $275,000 in cash without selling a substantial portion of his stocks in the automobile dealerships. In the event of the sale of sufficient stock to raise that amount, his capital investment in the dealerships would have been reduced below the minimum capital standards required in his dealer franchise contracts, and he feared that such a reduction would result in the cancellation of the franchises.

(b) Although Dixie Gilmore's attorneys stated that she would accept stock in lieu of cash in payment of the settlement, Don Gilmore feared that the General Motors Corporation would not accept Dixie Gilmore as a shareholder in the corporations and would cancel the franchise contracts pursuant to the contract provision quoted in finding 16.

(c) His attorneys advised Don Gilmore that any increase in the value of the separate property of a spouse as a result of his personal efforts or services during marriage was recognized by California law as community property, but that any increase in value of the stocks due to a return on the investment remained separate property. After examining his books and records, his attorneys further advised him that they had determined that during the marriage he had drawn salaries from the corporations in amounts which the attorneys felt were the maximum salaries that the Internal Revenue Service would recognize as reasonable compensation for managing officers of automobile dealerships and that all of the proceeds of the salaries had been spent by Don Gilmore and Dixie during their marriage. Accordingly, they advised him that any additional increment of value accruing to his shares of stock in the dealerships during the marriage was his separate property and not community property.

21. After the efforts to settle failed, the action went to trial in the Superior Court. The trial consumed a period of 24 days, and the reporter's transcript of the case consisted of 11 volumes containing 3,063 pages.

22. With respect to the issues before him, the trial judge made the following statement:

> The primary issue here, aside from the divorce itself, is the question of the evaluation and determination of the defendant's separate or community property first, most noteworthy the claim set forth by Mr. Gilmore and his counsel that the increase, balance sheet increase, the increase in net worth, that is, overall net worth of his interest in the agencies represented by his holdings.

23. The issue as to which party was entitled to be granted the divorce arose out of allegations by Dixie Gilmore that Don Gilmore was guilty of extreme cruelty and adultery and by the allegation of his cross-complaint that she had been guilty of a continuous course of misconduct that constituted extreme cruelty. The evidence, including the transcript of the evidence at the divorce trial, reflects that the major portion of the evidence presented by both parties and the time required for its presentation were devoted to the misconduct charges. A considerably smaller portion of the evidence related to the question of whether the increase in the value of Don Gilmore's stock was community property.

However, after Dixie Gilmore took the initiative in raising charges of misconduct on the part of Don Gilmore, his attorneys determined that it was necessary to resist these charges by extensive cross examination of Dixie Gilmore, by rebuttal evidence, and by evidence of misconduct on the part of Dixie Gilmore, for the following reasons:

(a) Under California law, the court must award more than 50 percent of the community property, and may award all of the community property to the innocent spouse in divorces based on extreme cruelty or adultery, the grounds alleged by Dixie Gilmore.

(b) The credibility of the parties became an important factor in the evaluation by the trial court of the entire case, including both the misconduct and community property issues. Don Gilmore's attorneys feared that if the trial judge believed Dixie's charges, he might also find that there was community property and award all or most of it to her.

(c) There was an issue as to whether oral declarations and conduct between the parties had affected the nature of the property in dispute.

(d) Dixie Gilmore's charges of misconduct by Don Gilmore were published in the local newspapers. As a result, Don Gilmore feared that if the allegations were established and a divorce based on such charges was granted to Dixie Gilmore, the General Motors Corporation might cancel his dealership franchises. Although the evidence does not show whether or not his fears were justified, he and his attorneys felt it necessary to refute Dixie Gilmore's accusations and to prove misconduct on her part.

24. In preparation for and during the trial of the divorce suit, Don Gilmore's attorneys devoted considerable effort in establishing that no portion of the increase in the value of his stock constituted community property. The most important evidence presented by Mr. Gilmore's attorneys on the community property issue consisted of (a) proof that the salaries paid him by the corporations in which he owned stock represented more than ample compensation for the services he rendered as an officer of these corporations, and (b) proof presented through a certified public accountant that the community obligations and expenses that had been paid during the marriage exceeded the salaries and other community income that Don Gilmore had earned during the marriage.

25. In addition to the principal issues described above, the questions of whether Dixie Gilmore was entitled to alimony and whether two houses in which the parties had lived were held in joint tenancy were also before the court in the divorce action. Before the trial began, Don Gilmore's attorneys anticipated that the court would direct the payment of alimony to Dixie Gilmore for a period of two or three years, since that had been the usual practice of many of the Superior Court judges in divorce actions where the marriages were of short duration. The evidence shows that little time and effort were devoted by Don Gilmore's attorneys on the alimony issue. Although there was a question as to whether two residences in which the parties had lived were held in joint tenancy, very little evidence was required to dispose of the matter, because the deeds to the properties were admitted in evidence and showed, as the court held, that the houses were in fact held in joint tenancy by Don and Dixie Gilmore.

26. As shown by the decision of the California Supreme Court in *Gilmore* v. *Gilmore*, 287 P. 2d 769, there were two methods which had been used by the California courts in making an allocation between community and separate property. One method (the one urged by Dixie Gilmore's attorneys) for determining what part of an increase in the value of a business is community property is to subtract from the total increase a reasonable return on the value at the time of the marriage and treat the remainder as community property.

The other method—advocated by Don Gilmore's attorneys and adopted by the trial court—is to deduct from the total earnings of the business the value of the husband's services to it. The remainder, if any, represents the earnings attributable to the separate property invested in the business. The trial court's decision in this respect was affirmed by the California Supreme Court on the basis of the trial court's findings that Don Gilmore's corporations were staffed by well trained personnel who were capable of carrying on the businesses unassisted; that he worked relatively short hours and took many extended vacations; that the salaries he received, constituting community income, were more than ample compensation for the services he rendered, and that during the period involved there was a tremendous increase in the automobile business that was accompanied by an increase in the value of dealer franchises.

27. After Dixie Gilmore appealed from the interlocutory decree rendered by the Superior Court, it was necessary for Michael L. Haun and Wallace S. Myers, as Don Gilmore's attorneys, to spend considerable effort, research, thought, and planning on the appellate proceedings and to write briefs and make arguments before the appellate courts during 1953, 1954, and 1955. A reversal of the trial court's decision or the granting of a new trial would have deprived their client of the success achieved at the trial.

28. During 1953 and 1954, Don Gilmore paid the following amounts for work or services rendered by his attorneys and others in connection with the divorce litigation:

1953

Michael L. Haun, attorney	$8,281.50
Walter F. Freitas, attorney	3,500.00
Wallace S. Myers, attorney	14,265.00
R. L. Schwerin, C.P.A.	1,500.00
Court reporters	4,990.65
Total	32,537.15

1954

Michael L. Haun, attorney	$5,250.00
Wallace S. Myers, attorney	2,000.00
Pernau-Walsh Printing Co. (briefs on appeal)	804.21
Court reporter	20.00
Total	8,074.21

(a) When Dixie Gilmore appealed from the interlocutory judgment, Don Gilmore was ordered by the trial court to pay for a transcript of the trial proceedings and paid the $4,990.65 listed above to two court reporters for their preparation of the transcript.

(b) In connection with the trial of the divorce action, Don Gilmore's attorneys retained on their client's behalf Robert Schwerin, a certified public accountant, who made an examination of Don Gilmore's books and prepared accounting schedules showing that the community expenses of Don and Dixie Gilmore during their marriage were greater than his salaries and other community income during the same period. The schedules were admitted in evidence in connection with Mr. Schwerin's testimony in the divorce suit. He was paid a fee of $1,500 for the services he rendered for Don Gilmore.

(c) Walter F. Freitas is an attorney who represented Don Gilmore after the divorce suit was filed, but he withdrew from the case shortly before it went to trial. He represented Mr. Gilmore in the negotiations for settlement and in the taking of depositions before the trial itself began. Don Gilmore paid him $3,500 for the legal services he rendered in this connection in 1953.

(d) Michael L. Haun served as Mr. Gilmore's attorney from date of the filing of the divorce action until the final judgment was entered after the decision of the California Supreme Court on appeal.

(e) Wallace S. Myers, an attorney, was employed by Mr. Gilmore to represent him about February 1953, after the

divorce suit was filed, and he continued with Mr. Haun to represent Mr. Gilmore thereafter throughout the trial and appeal of the case until final judgment was entered.

(f) As indicated in the foregoing table, the sum of $804.21 was paid by Don Gilmore in 1954 to the Pernau-Walsh Printing Co. for printing briefs on the appeals from the interlocutory decree of divorce.

(g) Don Gilmore also paid $20 to a court reporter for services rendered in connection with the divorce litigation in 1954.

29. None of the three attorneys who represented Don Gilmore kept records in which he undertook to allocate what percentage of his time or efforts was devoted to each of the several issues involved in the divorce litigation. However, each of them testified that more than 80 percent of the legal services which they rendered and for which they were paid by Don Gilmore in 1953 and 1954 were directed toward preserving his stock in the three dealerships as his separate property and in defeating Dixie Gilmore's claim that she was entitled to one-half of the increment in the value of that stock that occurred during the marriage. The attorney who represented Dixie Gilmore in the appeals testified that he was unable to determine the percentage of effort that the attorneys for either side devoted to the several issues, because the factual issues regarding misconduct and community property merged and overlapped in view of the fact that the California law requires the court to award more than 50 percent of the community property to the innocent spouse in cases where a divorce decree is awarded on grounds of adultery or extreme cruelty.

If Dixie Gilmore had succeeded in obtaining the community interest she claimed in the stock of the automobile corporations and the dealership contracts held by Don Gilmore had been canceled because of his failure to maintain the minimum ownership of capital required by such contracts, he would have lost his positions and salaries as an officer of the corporations and, as stated in finding 14, he was too old at the time to get a similar position with other automobile dealers.

30. The evidence, particularly the facts set forth in finding 23, establishes that 80 percent or more of the amounts which

Don Gilmore paid to his attorneys and his accountant in 1953 and to his attorneys in 1954 were for services rendered by them to defeat Dixie Gilmore's claims to one-half of the value of the increase of his stock in the three dealership corporations, and to establish that no portion of such stock was community property.

31. (a) Don Gilmore timely filed his individual income tax return for the calendar year 1953 with the District Director of Internal Revenue at San Francisco. Mr. Gilmore reported a total tax liability of $18,209.86 and further reported that of this sum, $14,643 had been paid as income taxes withheld from his salaries by his employers and by excess F.I.C.A. tax payments. By this computation, there was a balance due of $3,566.86, which he paid with his return.

(b) His 1953 tax return reflected the following allocations of salaries received and taxes withheld:

INCOME:			
Salaries:	*Total*	*Don Gilmore*	*Dixie Gilmore*
Don Gilmore, San Francisco	$49,999.92		
Don Gilmore, Hayward	10,800.00		
Don Gilmore, Riverside	6,000.00		
	66,799.92	$50,099.92	$16,700.00
Parties divorced.			
Community status through 7-1-53.			
Allocation of Withholding Tax:			
Don Gilmore, San Francisco	$15,000.00		
Don Gilmore, Hayward	3,240.00		
Don Gilmore, Riverside	1,176.00		
Excess F.I.C.A. Tax	108.00		
	19,524.00	14,643.00	4,881.00

(c) Among others, Don Gilmore took a deduction in his 1953 income tax return in the sum of $31,377.20 for "Costs of defending properties & investments. Legal fees and accounting costs".

(d) In his 1953 tax return, Mr. Gilmore also claimed deductions for the following taxes which he allocated as follows:

	Total	*Don Gilmore*	*Dixie Gilmore*
California income taxes	$5,643.10	$4,691.22	$951.88
Unemployment tax	30.00	22.50	7.50

32. (a) Don Gilmore timely filed his individual income tax return for the calendar year 1954 with the District Director of Internal Revenue at San Francisco, reporting a tax liability of $7,098.71, taxes withheld of $11,879.67, and an overpayment of income taxes for the year in the sum of $4,781.84.

(b) Among the deductions claimed in his 1954 return, was one in the sum of $6,499.37 for "Costs of defending properties and investments—legal fees".

(c) In the same return he also reported the payment and allocation of the following State income and unemployment taxes:

Taxes:	*Total*	*Don Gilmore*	*Dixie Gilmore*
State Income Tax	$1,492.84	$1,492.84	
State Income Tax additional—1950–51	982.11	491.06	$491.05
Unemployment tax	30.00	15.00	15.00

33. Upon an audit of Don Gilmore's 1953 and 1954 individual income tax returns, the Commissioner of Internal Revenue made a number of disallowances and adjustments, including the following:

(a) The principal disallowances resulted from the Commissioner's determination that the attorneys' fees, accountant's fee, court reporters' fees, and printing costs, which Don Gilmore paid in 1953 and 1954 in connection with the divorce action, were personal expenditures of Don Gilmore and were not deductible under Section 24(a) of the 1939 Internal Revenue Code.

(b) The Commissioner determined that only $9,762, or one-half of the $19,524 income taxes withheld from Don Gilmore in 1953 should be credited to him, and this resulted in a finding by the Commissioner that $4,881 of the tax liability reported on the 1953 return of Don Gilmore had never been paid.

(c) The Commissioner of Internal Revenue also determined that of the $5,643.10, which Don Gilmore had paid in 1953 for State income and unemployment taxes, Mr. Gilmore was entitled to a credit in his return of only one-half, or $2,821.55, and that the balance was deductible by Dixie Gilmore.

(d) In his 1953 income tax return, Don Gilmore had erroneously reported that of the $66,799.92 of salaries paid

to him during that year, the amount of $50,099.92 was taxable to himself individually and the balance of $16,700 was taxable to Dixie Gilmore. The error caused his individual income for the year 1953 to be overstated by the amount of $16,699.96. This error was recognized by the Commissioner of Internal Revenue, who made an adjustment showing that only one-half of the total salaries paid were taxable to Don Gilmore individually.

34. As a result of various disallowances and adjustments (including some not now in dispute), the Commissioner assessed deficiencies in income taxes against Don Gilmore as follows:

Year	*Tax*	*Interest*	*Total*
1953	$18,883.26	$4,264.25	$23,147.51
1954	3,762.21	583.12	4,345.33

Such deficiencies in taxes were paid by Don Gilmore on November 15, 1957, and the interest thereon was paid November 27, 1957.

35. Don Gilmore and Sue Gilmore were married on November 1, 1955, and on April 15, 1956, they filed with the District Director of Internal Revenue at San Francisco their joint income tax return for the calendar year 1955, showing a tax liability of $10,137.52, claiming withholding tax and estimated tax credits of $22,203.21, and asserting an overpayment of $12,065.69. In the return, the taxpayers requested that the overpayment be credited on their 1956 estimated income tax.

36. (a) In the 1955 tax return, Don and Sue Gilmore reported the following:

Employer:	*Wages, etc.*	*Income Tax Withheld*
Don Gilmore, San Francisco	$20,583.29	$7,583.29
Don Gilmore, Hayward	16,800.00	6,126.00
Don Gilmore, Riverside	10,800.00	3,544.08
Excess FICA		168.00
	48,183.29	17,421.37

This return includes all earnings of Don Gilmore during 1955 over which he had complete control, including any share thereof which Dixie Gilmore, his divorced wife, may possibly claim as her share of community income for the period January 1, 1955 to and including the date of the final decree of divorce in October 1955.

(b) In the 1955 return, they also took a deduction of $4,236.66 for "Costs of defending properties and investments—Legal Fees."

(c) As shown by the above-quoted table, the taxpayers in their 1955 return claimed a credit for all taxes withheld from Don Gilmore's salaries in 1955, including the amount withheld prior to October 25, 1955, when the final decree of divorce was entered, as well as the taxes withheld between that date and the end of the calendar year.

37. Don Gilmore received the amount of $42,433.29 as salaries from his employers, Don Gilmore—San Francisco, a corporation, Don Gilmore—Hayward, a corporation, and Don Gilmore—Riverside, a corporation, after December 31, 1954 and prior to October 25, 1955.

In addition Don Gilmore received on October 31, 1955, the following amounts as salaries from his employers for the period from October 16, 1955 to October 31, 1955:

From Don Gilmore—Hayward, a corporation	$700.00
From Don Gilmore—Riverside, a corporation	450.00

In addition, Don Gilmore received the amount of $4,600 as salaries from his employers after October 31, 1955, and prior to January 31, 1956.

38. On the basis of the decision in *Waters* v. *Waters*, 170 P. 2d 494 and other authorities, it is the plaintiffs' position herein that all 1955 salaries earned by Don Gilmore prior to October 25, 1955, when the final decree of divorce was entered, were community income of Don Gilmore and Dixie Gilmore. Thus, according to plaintiffs' computation, the $42,433.29 which Don Gilmore earned as salaries from January 1 to October 16, 1955, was community income and that $718.75 of the $1,150 in salaries which he earned in the period from October 16, 1955 to October 31, 1955, is also community income of Don Gilmore and Dixie Gilmore. Plaintiffs' addition of the two amounts yields a total of $43,152.04 as the total 1955 community income of Don and Dixie Gilmore.

39. The taxpayer, Don Gilmore, filed a timely claim for refund of income taxes paid for the year 1953 on the following grounds:

1. 80% of expenses for legal fees of taxpayer's attorneys, and of other costs in divorce proceedings (except fees paid to attorneys for Dixie Gilmore), were incurred and paid during the taxable year for the conservation of the taxpayer's income-producing property. They are therefore deductible expenses. They were erroneously treated by the Commissioner as personal expenditures.

2. The Commissioner had erroneously credited to Dixie Gilmore, and refused to credit to the taxpayer, amounts of income tax withheld from the taxpayer's salary by his employer and which were deposited by taxpayer's employer to the taxpayer's credit with the District Director of Internal Revenue.

3. The Commissioner has erroneously allocated to Dixie Gilmore, and refused to allow as a deduction from the taxpayer's gross income, income taxes paid to the State of California by the taxpayer for his account and not for that of Dixie Gilmore, in the amount of $1,877.17.

4. The Commissioner has erroneously credited to Dixie Gilmore, and disallowed as an expense of the taxpayer, amounts of unemployment insurance tax paid for the taxpayer's account to the State of California. These amounts were expenses of the taxpayer and were not paid for or expenses of Dixie Gilmore.

40. The taxpayer, Don Gilmore, filed a timely claim for refund of income taxes paid for the year 1954 on the following grounds:

80% of expenses for legal fees of taxpayer's attorneys, and of other costs in divorce proceedings, were incurred for the conservation of the taxpayer's income-producing property. They are therefore deductible. They were erroneously treated by the Commissioner as personal expenditures.

41. The taxpayers, Don and Sue Gilmore, filed a timely claim for refund of income taxes paid for the year 1955 on the following grounds:

Don Gilmore was previously married to Dixie Gilmore, and this marriage was dissolved by a final decree of divorce effective Oct. 25, 1955. Wages, etc. paid to Don Gilmore between Jan. 1 and Oct. 25, 1955, were community income of Don Gilmore and Dixie Gilmore, of which one-half is taxable to Dixie Gilmore. The present taxpayers, Don and Sue Gilmore, erroneously reported all of such income as their community income, and are filing this claim to eliminate from their gross

income the portion thereof which is taxable to Dixie Gilmore.

42. More than 6 months had elapsed after the filing of the above-described claims for refund before this action was brought. No action had been taken by the Commissioner of Internal Revenue on the claims for refund by that time.

DEFENDANT'S COUNTERCLAIM

43. Defendant was granted permission to assert at the trial a counterclaim against Don Gilmore for each of the years 1953 and 1954 for unpaid income taxes assessed against Dixie Gilmore for those years. The counterclaim was filed December 15, 1959, and the allegations thereof were denied by plaintiff, Don Gilmore.

44. Shortly prior to June 19, 1957, an Internal Revenue agent prepared delinquent income tax returns for Dixie Gilmore for the years 1953 and 1954. The agent did not discuss the contents of the returns with Dixie Gilmore, but prepared such returns on the basis of a report made by another Internal Revenue agent who had examined the income tax returns of Don Gilmore for the years 1953 and 1954. After the returns for Dixie Gilmore had been prepared, they were mailed to her for signature, and on June 19, 1957, her then attorney delivered the returns, which had been signed by Dixie Gilmore, to the Internal Revenue Service and they were filed on that date.

The total tax liability reflected by the return for Dixie Gilmore for 1953 was $13,625.78. Against this liability a credit for income tax withheld in the amount of $9,762 was applied, leaving a balance of tax due in the amount of $3,863.78. On December 31, 1957, interest up to that date in the amount of $879.51 was assessed, making a total balance then due of $4,743.29.

The return for Dixie Gilmore for 1954 reflected a total tax liability of $11,958.59. A credit of $11,879.66 for income taxes withheld was applied, thus leaving a balance of $78.93 due for 1954 income taxes. On December 31, 1957, interest of $13.23 was assessed, making a total of $92.16 due as of that date.

45. A demand for the payment of the 1953 and 1954 income taxes and interest was first made on Dixie Gilmore on January 7, 1958, and on March 28, 1958, tax liens were filed against Dixie Gilmore for the unpaid income taxes, plus interest, in Napa County, California. The record does not show what additional attempts, if any, have been made to collect such taxes from Dixie Gilmore.

46. Defendant's counterclaim is based on its contention that during the years 1953 and 1954, Don Gilmore, as the husband of Dixie Gilmore, had full and complete control of the community income and is liable for the unpaid income taxes of Dixie Gilmore, together with the interest due thereon.

47. The final judgment of divorce entered by the Superior Court of Marin County, California, on October 25, 1955, in *Dixie Gilmore* v. *Don Gilmore* provided in part:

> It is FURTHER ORDERED, ADJUDGED AND DECREED that there is no community property belonging to the parties hereto.

48. When the 1953 and 1954 individual income tax returns of Don Gilmore were reviewed and audited by the Internal Revenue Service (finding 33), the report of examination (Exhibit 21), stated that since the interlocutory decree of divorce of June 30, 1953, did not adjudicate community property income rights for the interlocutory period, salaries earned during the interlocutory period constituted community property income and that one-half of such income was legally the income of the taxpayer's former spouse, Dixie Gilmore. As shown in finding 33(d), the Internal Revenue Service adjusted Don Gilmore's 1953 return so as to show that only one-half of the total salaries he received that year was taxable to him individually.

49. On or about October 25, 1955, when the final decree of divorce was entered, the attorneys who represented Dixie Gilmore on appeal demanded an accounting of any accumulations of community property during the period between the interlocutory decree of June 30, 1953, and the final decree of October 25, 1955. It was established at that time that the community income during the period involved was considerably less than payments made by Don Gilmore for community expenses and obligations.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiff is entitled to recover, and judgment will be entered to that effect.

The court further concludes as a matter of law that the defendant is not entitled to recover and, accordingly, its counterclaim is dismissed.

The amount of recovery will be determined pursuant to Rule 38(c) of the Rules of this court.

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